

Executive



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SPECIAL REPORT

FINANCIAL ECONOMY

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WHAT SPECIAL DRAWING RIGHTS CAN DO AND WHAT THEY CANNOT DELIVER



Lebanon's Prime Minister Najib Mikati (R) meeting with Ernesto Ramirez-Rigo (L), the International Monetary Fund's (IMF) head of mission for Pakistan, Middle East, and Central Asia, and his accompanying delegation at the government palace on December 7, 2021.

Explaining the rules of the IMF

On August 2, 2021, the International Monetary Fund (IMF) approved the distribution of a new package of Special Drawing Rights (SDRs) amounting to SDR 458 billion to all its member countries. Each country willing to participate has been allocated approximately its relative share in the quota system. The local media published the good news, and how the amount allocated to Lebanon, (estimated at SDR 605 million, which are equivalent to approximately USD 860 million), would be spent. Initial media reports neglected to mention previous cumulative distributions in favor of Lebanon, which amounted to SDR 196 million, to bring the total to SDR 801 million (USD 1.137 billion).

Describing the SDRs as “a shot in the arm for the world” in a time of many crises, IMF managing

director Kristalina Georgieva presented the 2021 allocation with a message that countries could reduce their reliance on more costly debt. It must be noted, however, that SDR is a form of debt like any other debt when used but at the SDR rate rather than market rate. “Countries can use the space provided by the SDR allocation to support their economies and step up their fight against the crisis,” she said. Additionally, the IMF has been deliberating on possibilities of channeling more of these precious resources from its stronger members to countries in need with the tools of its Poverty Reduction and Growth Trust and a new Resilience and Sustainability Trust.

The worldwide SDR allocation includes Lebanon at a time of renewed urgency to realize an

agreement with the IMF. However, there is no connection between SDR allocations and IMF negotiations. The SDR department is a separate and independent department and has nothing to do with negotiations with the IMF through its General Resources Department. It has a complex structure that may or may not be conveyed clearly in IMF statements. Whereas any SDR inflow to our country can be good news, it is premature to speculate how the aforementioned sums of the Lebanese allocation or any eventually mobilized flows through above trusts will be spent. At this point, it rather is necessary to explain the modus operandi of the IMF and the role of Lebanon as an IMF member, to clarify the picture and the impact of this distribution.

The IMF was established in 1944 by 44 countries. Lebanon joined in 1947. It currently includes 190 member countries. The main objective of its establishment was to create an institution that fosters international economic cooperation, develops international trade and growth, and maintains the stability of the global financial system. According to the IMF's bylaws, "The key functions of the IMF are the surveillance of the international monetary system and the monitoring of members' economic and financial policies, the provision of Fund resources to member countries in need, and the delivery of technical assistance and financial services." To achieve this, the fund has been monitoring from its early days the economic and financial developments and the balance of payments of member countries. It provides the necessary advice to member countries facing economic troubles and shortage of hard currency reserves. It also provides foreign currency reserve financing to central banks that face protracted balance of payments deficits and a severe and critical decline in their reserves that could hamper the respective country's trade in goods and services.

THE TWO MAIN DEPARTMENTS OF THE IMF

The IMF consists of two main departments: the General Resources Department and the Special Drawing Rights Department. The fund is managed by a Board of Governors comprising two representatives from each member state. The Executive Board, consisting of 24 elected executive directors, oversees the management of day-to-day operations. Moreover, all the IMF's financial capacities are calculated on the SDR (the IMF's unit of ac-

count). One SDR is composed of a basket of five major currencies. At the time of writing this article, the value of one SDR equates the sum of USD 0.58, €0.387, £0.0859, ¥11.9 and 1.017 Chinese renminbi. The currency shares reflect the quota of each of these countries and the European Union.

The currency amounts of the SDR are allocated once every five years, or earlier if needed, while ensuring that the basket mirrors the relative importance of the five currencies in the world's financial system. Cross-exchange rates determine the actual weights of the currencies. The value on the other hand is a daily determination according to the market exchange rates.

The Special Drawing Rights Department is responsible for distributing SDRs as needed, free of charge, to stimulate international trade, and it is entitled to cancel these rights. The department is independent of the General Resources Department.

■ The worldwide SDR allocation includes Lebanon at a time of renewed urgency to realize an agreement with the IMF

It was established in 1969 with the aim of providing additional voluntary reserves to member states. Each country receives a share of each distribution as a percentage of its quota in the fund. The total distributions of SDRs carried out in several stages amounted

to SDR 662 billion, including the last distribution of SDR 458 billion. The distribution is recorded in each country's account at the IMF as both credit and debit entries. So on a net basis, the distribution does not provide additional reserves.

Each Friday, the IMF dictates the SDR interest rate. It is based on the weighted average of a 3-month debt interest rate in the five countries' money markets. Each member must pay interest on the quantities of SDRs it uses, and abide by Article 19 of the IMF Agreement, which clarifies the terms and conditions of swapping the SDRs with reserve currencies. The most important clause in Article 19 is the third clause, which requires the country to show the need to use the SDRs to finance the balance of payments, and not for the subsidization of goods, which falls within the scope of the Ministry of Finance.

Holding SDRs is considered as a potential reserve and not as an actual foreign currency reserve, as the SDRs are not used in external financing until they are exchanged for reserve currencies in accordance with the country's ability to comply with

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all the terms of the Voluntary Exchange Arrangement, set up by the IMF as a platform to facilitate exchange of SDRs with other currencies. Whereas all members are entitled to participate in the Special Drawing Rights Department, they are not obligated to respond to any transaction related to the use of SDRs.

Most SDR transactions in the Special Drawing Rights Department are currently conducted under the supervision of the IMF's platform of Voluntary Exchange Arrangement.

Since the Lebanese central bank Banque du Liban (BDL) had not previously resorted to using the Special Drawing Rights Department, it seems prudent if the central bank were to investigate the details of its *modus operandi* to determine its ability to replace SDRs with currency reserves. We must be aware that resorting to this department depletes the country's holdings of special drawing rights and requires its service according to the prevailing interest rate on SDRs. Using SDRs comes at a cost, and in no way should they be perceived as a grant.

URGENT NEGOTIATIONS WITH THE GENERAL RESOURCES DEPARTMENT

The IMF obtains its resources in the General Resources Department, which was established at its inception to help countries facing shortages in their reserves, from subscriptions of member countries to the IMF capital, which is based on a quota system that reflects the size of each member country such as the size of its GDP, foreign trade, and reserves. The quota is managed by the General Resources Department. Lebanon's share in the General Resources Department is only SDR 633.5 million (0.1 percent) out of the total quota of SDR 477 billion.

25 percent of the quotas of each member are paid in hard reserve currency (reserve quota) while the remaining 75 percent are paid in a country's local currency. Therefore, Lebanon's share of unconditional ready-to-use reserves in the IMF is only SDR 158 million (USD 224 million), but if it expresses the need to finance its balance of payments, it may have access to more IMF lending. The country can use other IMF facilities as needed and during a specified period within a maximum withdrawal limit ranging between 50 percent and 145 percent of the quota annually, taking into account the country's ability to serve its debt obligation resulting from such borrowing and ability to adhere



Lebanon's Finance Minister Ghazi Wazni (R) meeting with IMF Alternative Executive Director Sami Geadah, 2020.

to a reform program. As a maximum, a country could access about 400 percent of the quota if it undertakes a serious reform, while continually meeting the performance indicators of the reform programs agreed upon with the IMF. The repayment of these facilities would usually start within a few years. The crucial issue is to determine the need for these funds and the capacity of the country to service such debt which will become due within a short period of time.

■ Borrowing from abroad without reform may once again lead [Lebanon] to a potential default on its foreign currency debt service

Resorting to the General Resources Department in excess of the reserve quota requires an agreement between the IMF and the Lebanese state. It has been firmly established that the reaching of such an agreement is contingent on stringent reforms, the most important of which, in the case of Lebanon, is seeking to achieve sustainable fiscal and balance of payments balance. Borrowing from abroad without reform may once again lead to a potential default on its foreign currency debt service, which has been the main cause of the current crisis. ■

Mounir Rached, PhD, is the president of the Lebanese Economic Association (LEA) and a former IMF Senior Economist (1983-2007). Executive editors contributed to the updating of this comment piece originally published in Arabic on August 26, 2021 in Al Joumhouria.

PERSEVERANCE

The Key to **OLX's** Success



OLX started in Lebanon in 2015 and witnessed tremendous adoption from the Lebanese population at a very quick pace. "During the early days when we first launched, OLX Lebanon was always mentioned within our group as the Star Country because the Lebanese population showed a real hunger for innovation and an adaptability to new methods of transacting more than any other country in the region", shares Maria Nehme, OLX Lebanon's recently appointed Country Manager when discussing with us the company's vision for Lebanon. Because of this, the Group decided to open the office in Lebanon in 2017, in Beirut Digital District.

Since then, OLX has gone through so much, as have most of companies in the country like the flourishing of the real estate market, the growth of the cars' market, the 2019 revolution, the COVID pandemic, the 4th of August explosion and Lebanon's most acute economic crisis in its history. With these ups and downs, OLX Lebanon has not stopped fighting, not even for a day. "During the pandemic days, we really pushed to keep operating normally. As a team, we used to meet on a daily basis through videoconferencing in the morning for the "Daily Morning Coffee". This helped us in keeping everyone's spirits up and the momentum going. Some days, because of the revolution or the lockdown, our commercial team could not circulate to meet their clients; that did not stop them. They started working on long term projects to strengthen the company's core and develop new services", Maria tells us.

During the pandemic and crisis, we learned that the company witnessed a very paradoxical effect: on one hand, there was a full lockdown and a lot of businesses were freezing their activities. On the other hand, the traffic on the OLX website and app almost doubled across categories, especially on the Goods categories including Mobiles, Electronics, Furniture and Fashion.

Maria continues: With consumers locked in their home for several months, we noticed a need to facilitate remote transactions. From these pain points came the idea of our new baby: OLX Store, OLX's end-to-end E-commerce platform allowing you to order any item from the comfort of your home.

The group noticed a lot of shifting and reinventing across industries and they couldn't be watching the train. This is where they took control of the train across their verticals and drew the road for OLX in Lebanon. In Real Estate, they introduced Virtual Reality where they were the first platform offering users the ability to visit houses through 3D tours and from the comfort of their homes.

In Autos, they were betting on "convenience" by revolutionizing the car

selling experience. Maria elaborates: "Our users now have a choice to make: they can either list their car on OLX Autos and negotiate directly with buyers or they can benefit from our free Car Selling Experts service; this service allows them to schedule an inspection for their car at home and receive an offer within 48 hours. The service also includes facilitating the entire process through the property transfer."

In the Goods category, OLX is building an ecosystem that will create value across the economy. "First, we believe it should all start with nurturing the private sector and the businesses. At OLX, we want to be next to all businesses including start-ups, SMEs, medium and large-scale enterprises. We help businesses in creating their brands, advertising them, advocating for them and multiplying their sales. Our business services include advertising packages, sales consultancy, value-added services and so much more. At the end of the day, all we care about is creating value", Maria explained.

In parallel to businesses, Maria further expanded on how they want to facilitate transactions for individuals through a Circular Economy: In our vision of the future, individuals will be purchasing new items from OLX Store, once purchased and received, as a buyer and as a consumer, they will use the item and extract the most value out of it. However, when the time comes, and when they don't need this item anymore, instead of disposing of it, they can recycle it. This is where our OLX Classifieds app would come into play: at this stage, OLX will be next to the user turning them into sellers to make sure someone else in the ecosystem can benefit from the same item that is now obsolete for one but, precious for another; "New is in the eye of the beholder".

And with this the entire ecosystem is geared toward value creation, not to mention how meaningful this is for our environment.

We asked Maria, "What is OLX's Vision for Lebanon?"

"Despite all of what is happening in Lebanon," Maria says, "we have a deep and honest belief in the country's potential and capabilities. Our team of 70 highly educated and driven individuals is a sample of these capabilities and a real pride for us. This is why we are still investing resources in the country; we see ourselves continuing to grow across all of the industries with 3 obsessions in mind: Multiplying transactions across industries and regions, improving customers' daily lives through technology and convenience and constantly finding new opportunities and new markets."

REFORMS AND THE FATE OF DEPOSITS



A self-bailout as a solution

A key driver of the Lebanese economic crisis has been the losses incurred by the public sector. These losses have impaired the banking sector and, through it, the deposits of many citizens. Banks had committed the bulk of client deposits to the central bank, Banque du Liban (BDL), which in turn had used them to finance the expenses of the government and public institutions. In relying on Lebanese citizens' deposits to cover public deficits, Lebanese authorities have abused trust and failed to ensure the effective and transparent management of the economy. Prior to the meltdown, the government had tried to placate citizens with the help of subsidies. Since 2019, citizens have borne the brunt of the crisis, reflected in rising unemployment rates, increased poverty, inflation, and degradation of deposits. With the beginning of the crisis, the politically divisive debates raged over the right strategy to address the progressing degradation of deposits. Both the subsidy policies and attempts to stop the degradation by measures forced upon the banking sector have failed in fulfilling the hopes of

citizens and wishes of the government. After two years of financial disarray, priority should be given to compensating for US dollar deposits that banks have placed in BDL, as these make up more than 60 percent of total deposits, and are not backed up by any guarantees.

For citizens, freeing their deposits is the top concern. The current government statement of policy in September 2021 responded to this issue by emphasizing that the reform plan for the banking sector will be "prioritizing the safeguarding of depositor rights and funds." The public sector is responsible for depleting the citizens' funds, and must shoulder the consequences. The private sector has endured enough. A haircut on deposits or a distribution of losses between the private and public sectors might be the simplest, but also, the worst solution. It could be challenged constitutionally and judicially. Moreover, a haircut has already been applied on depositor withdrawals. It has cost citizens an estimated \$5 billion in losses. In total, measures taken by the government and BDL since the beginning of the crisis have accelerated, rather than resolved, the economic and financial freefall. The government has not even shown interest in addressing the matter. Therefore, how can the state really commit to restoring citizens' savings and rebuilding trust?

FIRST: REFORMS

The first step to restoring trust is adopting monetary, financial, and structural reforms; namely the immediate unpegging and standardization of the exchange rate for all transactions, given the serious damage that multiple exchange rates can have on the economy.

It has been argued that unpegging the exchange rate from the previous low rate of 1,500 Lebanese pounds on the dollar would further increase inflation. By that reasoning, if one believes that the added liquidity would be detrimental to the economy, one must first recognize that the damage from multiple exchange rates and the freezing of deposits has been, and will be, far more disastrous than the damage of adding liquidity. Unpegging the ex-

change rate and operating deposit withdrawals at the unpegged rate may alone provide an important solution to the deposit access dilemma.

Under this solution, depositors would be content with cashing their US dollar deposits in Lebanese pounds at the market rate. As such, they would cease making cash transactions that have flooded the economy with liquidity and accelerated the collapse of the Lebanese pound. Unpegging the exchange rate is inevitable. It is better to adopt it immediately rather than pay the far higher cost of delaying it.

SECOND: A SELF-BAILOUT BY BDL

As a second step, or simultaneously, the matter of deposits in US dollars in BDL must be addressed. These deposits, without backing of guarantees, amount to around \$65 billion, out of a total of \$106 billion of deposits as at end June 2021. The remaining 39 percent of deposits are invested in the private sector and bonds, and backed by guarantees.

The \$106 billion deposits were deployed by banks as follows:

- Deposits in BDL amounting to around \$65 billion (an estimate, since BDL does not disclose this figure).
- Investments in Eurobonds payable by the Lebanese State (\$8 billion).
- Lebanese pound and US dollar denominated loans to the resident and non-resident private sector in US dollars (\$23 billion).
- Other bank assets in foreign currencies, including holdings of equity (shares) in branches abroad (\$10 billion). These shares are considered foreign assets.

To compensate depositors for their deposits that have been invested by banks in BDL, the public sector's real and monetary assets must be used. Drained deposits at BDL are supposedly unavailable, marked as losses (in the electricity sector and other dossiers), and are not guaranteed. The public sector as a whole carries the blame of squandering these funds. This devastating practice has been facilitated by the indifference or inability of oversight bodies, namely, the legislative and executive authorities, to ensure effective monitoring of banking sector performance, despite decades-long warnings by experts and international financial institutions about risks of exceeding the solvency.

The simplest and most effective method by which the public sector can take responsibility for restitution of squandered funds is, first, to restore depositors' funds by using the remaining BDL cash

assets in foreign currencies, similarly to when the private sector defaults on obligations. It is still possible to restore \$14 billion in cash to banks from the remaining mandatory reserves.

Moreover, the government may reconsider liquidating part of the gold reserves and depositing the amount in banks to compensate depositors for the funds. Believing that gold is a bond of trust is indeed wrong. It gives false trust in economic performance. It is widely known that gold is considered worldwide as part of monetary reserves and is used as such.

Once the exchange rate is unpegged and BDL ceases to supply foreign currency to the market, management becomes more effective, and will focus, by default on the management

of liquidity in the national currency.

Secondly, state-owned real assets should be used through privatization to compensate depositors for the remaining \$51 billion. The total value of state institutions subject to privatization as a first stage (telecommunication – OGERO – aviation – Middle East Airlines, electricity, port operation contracts, real estate companies, airport and marine blocs – gas, oil, etc.) is estimated at no less than \$50 billion, based on projected profit under private administration.

FILLING THE \$51 BILLION GAP

Establish individual joint stock companies for each basic public sector institution, place them under private management as soon as possible, and issue shares denominated in US dollars, similarly to other companies listed on the Beirut Stock Exchange (such as Solidere, and others). This requires seeking out local and international expertise to form a commission in charge of achieving this goal and issuing new securities. These shares would be gradually offered through the Beirut Stock Exchange and made available to those interested, including resident and non-resident depositors. A sizeable portion of these shares would be bought by depositors through their bank accounts. As a result, deposits would be replaced with real assets, thereby reducing bank balance sheets by the corresponding amount. A reminder, the 2003 government reform plan for the electricity sector was based on the privatization of the power company, Electricité du Liban (EDL).

■ The first step to restoring trust is [...] the immediate unpegging and standardization of the exchange rate for all transactions

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Furthermore, shares in the privatized companies purchased through new accounts and international transfers would provide revenue in US dollars, which then would feed into the remaining bank deposits in US dollars. For depositors who do not wish to buy the new shares in the privatized companies, their deposits will remain in banks and these depositors will now have cash assets in foreign currency, proportionately to the level of subscription to these new shares by resident and non-resident investors.

In other words, the state would not be squandering public resources, but rather transferring ownership of public assets to citizens, while maintaining fair distribution by limiting individual ownership. Therefore, remaining non-liquid deposits will be exchanged for real shares from privatized state assets such as Middle East Airlines.

The resolution of state-owned assets would result in restoring the real monetary value of deposits that were dissipated in BDL. Deposits would either be in foreign currency, or consist of a mix of shares and deposits with long maturity dates of foreign currency and real assets. Part of the population who do not own bank deposits, would benefit from reforms, better management of the economy, and restoration of economic growth and job opportunities.

Those who oppose privatization, such as foreign consulting firms, aim at having Lebanon continue depending on foreign financing and depleting deposits, despite great risks.

Privatization and compensation for deposits are the optimal solution. Anti-privatization rationale argues that the public sector belongs to everyone, not only to depositors. This logic can be challenged by the very fact that the public sector's administration has made everyone go bankrupt, the rich, the poor, people who own deposits, and those who do not. The alternative to privatization is to let the state continue with poor management of public sector institutions, or rob citizens' deposits.

Moreover, privatization would enhance economic performance and improve the standard of living of Lebanese people of all classes. Thinking that selling state-owned institutions in the current situation would be selling them cheap is a flawed analysis because real assets are valued based on projected potential performance.

Accounts in banks and in BDL would be adjusted to reflect these transactions: bank deposits and the corresponding assets in BDL will decrease



proportionately to the value of shares purchased in the new companies using frozen deposits. The BDL budget, meaning the BDL balance sheet, will be reduced by the parallel \$14 billion, representing

■ The resolution of state-owned assets would result in restoring the real monetary value of deposits that were dissipated in BDL

the reserves returned to depositors, as well as by the extent of compensation for the remaining bank deposits in US dollars through privatization. To avoid bank runs on cash withdrawals from the remaining deposits, banks would

restructure the deposits in a multi-term plan; over sequential short to medium-term maturity.

There have been previous calls for the establishment of a sovereign fund for state institutions with the aim of using its profit to compensate for deposits. This is a futile proposition considering that the fund would still be managed by the incapable state, and compensation will take generations.

Finally, with regard to deposits in Lebanese pounds, these are guaranteed by secured loans and state bonds, and must be subject to a clear restructuring. Solving the dilemma of deposits and the availability of liquidity (in addition to other reforms) is necessary to restore trust and foster economic growth. Solving the overall deposit crisis will be the cornerstone of reforms and rebuilding trust. ■

Mounir Rached, PhD, is the president of the Lebanese Economic Association (LEA) and a former IMF Senior Economist (1983-2007). Executive editors contributed to the updating of this comment piece originally published in Arabic on August 28, 2021 in Al Joumhouria.

NEW INTERIOR



RESTAURANT BAR

Mar Maroun st. Saifi

CENTRALE

RESERVATIONS: 03 915 925 / 01 57 58 58



WHAT WAS WRONG WITH THE 2020 LAZARD PLAN?

A point-by-point analysis and critique

INTRODUCTION BY EXECUTIVE EDITORS

When the Council of Ministers approved an economic reform program at the end of April, 2020, then-Prime Minister Hassan Diab hailed the plan with the epithet that “the state has in its possession, for the first time in history, a complete and integrated financial plan.”¹

However, Diab’s optimistic assurance that this document, based on a study prepared for the Lebanese government by US-headquartered financial advisory firm Lazard, would “put an end to floundering financial policies that brought the country to the current state of collapse” was disputed long before the cabinet’s resignation in the aftermath of the August 4, 2020 Beirut Port explosion.

Diverse voices, from the banking industry to economists, academics, and economic media, offered critical responses, amendments, and counter proposals to the government rescue plan from the moment of its release. In one, from today’s ironic vantage point, for example, a document by various authors at the American University of Beirut (AUB) asked whether the government’s financial recovery plan was a “Rescue or Jeopardizing Plan.”² The introduction to the document noted that the plan does not call for celebration, but rather “generates valid concerns about its directions and goals.” This introduction was penned by Nasser Yassin, then director of the American University of Beirut’s Issam Fares Institute, and today minister of environment in Prime Minister Najib Mikati’s cabinet.

Other criticisms and counterproposals to the plan were listed on a webpage of the library of finance at the Institut des Finances Bassil Fuleihan.³ Issues of Executive Magazine that contain comment and analysis pieces on the numerous rescue proposals under discussion at the time include the February, March/April, and June/July issues of 2020.⁴ Given that a new rescue plan for the much worsened Lebanese economy is a matter of high importance, and that there have been references to Lazard in remarks by Prime Minister Mikati, Executive aspires to inform the debate by publishing, for the first time in an English-language magazine, the detailed critique of the Lazard plan by Mounir Rashed.

In his introduction to his critique of the Lazard plan, Rashed noted “several gaps” in the so-called reform agenda adopted by the former Lebanese Government. “Reviewing the government’s plan makes it evident that the plan sets the stage for further restrictions on the Lebanese economy while dismantling its vital private institutions, including banks, which may cause a rift between the country’s social classes,” Rashed wrote in an assessment that is as concerning today as it was then. He further elaborated in his analysis that the plan represents, among several erroneous assumptions on the economic structure of Lebanon, a blatant violation of the Lebanese constitution, submission to foreign interests, and is apt to further corrode citizens’ trust in the state.

The following article has been adapted from a confidential report written in May 2020. Most references in the text below are to the 2020 plan and the cabinet of Hassan Diab. The author has updated the text in November 2021 after Prime Minister Mikati started negotiations with the International Monetary Fund (IMF) and the Cabinet presented a revised financial recovery plan in end-November.



In general, the Lazard plan's framework displays a clear confusion between instruments and objectives, failing to differentiate between these two fundamentally different paths. Likewise, several of the proposed remedies are not expected to yield any short-term results in addressing the current crisis, such as fostering good governance and repatriating looted funds. Their proposals do not offer current solutions for the current bottlenecks, as they do not differentiate between immediate and long-term measures as demonstrated in the program's main list of pillars.

The purpose of these pillars is also not evident. It appears that the first objective consists of securing a financial recovery plan from the international community, thus perpetuating the crisis and the suffering of the Lebanese people, rather than adopting immediately effective measures with quick wins that would alleviate the burden befalling Lebanese citizens. The plan solicits the assistance of foreign institutions, which are oblivious to the Leb-

anese economic and social context. It also clearly does not take into account the recommendations of direct stakeholders, including the Lebanese central bank, Banque du Liban (BDL), banks, depositors, and the business community. Apparently, the plan assumes these interests have no role to play in the reform process.

The plan fails to indicate that resorting to foreign institutions for funding will come at a hefty price, as it entails several conditions that will undermine governance and the state's ability to fulfill its obligations towards Lebanese citizens. This will also perpetuate, and increase foreign debt servicing, and will weaken the resilience of reserve management and exchange rate.

It is important to note that the IMF's funding will be part of the overall debt plan, and that its debt service will be due in only a few years. In contrast, given that the interest of Lebanese citizens is directly aligned with that of the state, the plan could have resorted to generating domestic savings for funding, without resorting to a deposit "hair-cut." Above all, deposits should be safeguarded. The prevailing circumstances in Lebanon do not call for foreign funding. The current account of the Balance of Payments witnessed a significant drop in 2020 and was absorbed by BDL. As such, the Balance of Payments can still secure sufficient self-financing without having to resort to BDL's reserves

On the other hand, according to US investment bank Lazard Ltd., the "godfather" of the original financial recovery plan, foreign funding is estimated

■ The current system of multiple [exchange] rates engenders substantial untargeted subsidies and weakens the balance of payments

at a staggering amount of \$27 billion for the period of 2020-2024, meaning that in the next five years foreign debt will go from about \$8 billion to \$35 billion in the least, and to \$45 billion if we add the expected CEDRE loans, the majority of which

will be classified either as bilateral debt, or debt to international institutions.

EXCHANGE RATE

The plan suggests a gradual end to the Lebanese pound peg to the US dollar at the official rate of 1,507 Lebanese pounds per \$1. It stipulates that such a decision falls within BDL's competence, even though the decision has always been in the hand of the cabinet and Central Monetary Council.

Since 1997, successive cabinets pegged the

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Lebanese pound to the dollar, with BDL's Central Monetary Agency's approval. Therefore, it is recommended to inform citizens of the entity responsible for setting the exchange rate policy. The decision to unpeg the exchange rate and its subsequent depreciation were the outcome of the government's unsound fiscal policy. The accumulation of financial deficits, particularly in the electricity sector, have weakened the state's Balance of Payments and depleted a substantial chunk of BDL and the commercial banks' foreign currency reserves. The total debt in US dollar indicates that net foreign reserves were exhausted years ago. Additionally, the adoption of the previous cabinet's budget by the new government has also contributed to weakening the Lebanese pound further.

The government and Lazard's agenda suppose that the exchange rate is set at 3,500 Lebanese pounds per \$1 in 2020. Yet, we are well aware that the rate exceeded 4,000 Lebanese pounds per \$1 when the plan was formulated. This implies continuing to have multiple exchange rates practice, even though the government is aware of the repercussions this will entail. The current system of multiple rates engenders substantial untargeted subsidies and weakens the Balance of Payments.

Furthermore, the 2020 plan set the target exchange rate at 4,297 Lebanese pounds per \$1 by 2024, but the free market's exchange rate escalated to over 27,000 Lebanese pounds per \$1 at the time of writing this article.

CAPITAL CONTROL

The government's policy on capital control is yet to be announced. With the unpegging of the exchange rate, it is recommended that banks remove all discretionary controls on capital transactions for current account financing and transfer-

ring capital. Additionally, any restrictions imposed by banks in this regard must be governed through clear laws. Even the IMF announced that reform should precede imposing capital control measures. As evidenced over the past 18 months, banks' foreign exchange has been depleted.

MONETARY POLICIES

It is recommended that the government set objectives for its monetary policy in consultation with BDL. The plan called on BDL to gradually eliminate monetary funding to purchase treasury bonds. This proposal supposes that the government's fiscal policy will generate surpluses throughout the plan's duration, allowing BDL to retrieve treasury bonds, while the overall fiscal deficit will likely remain at an average of 4 percent of GDP throughout the plan's duration.

BALANCE OF PAYMENTS

In this context, the plan indicates that it would be unrealistic to think that the deposit flow will change direction in the near future, or that international markets will open their doors to Lebanon once again without a clear blueprint; the plan assumes that it will succeed in redirecting the money flow back into the country. However, assuming that the plan will generate a flow of foreign aid to Lebanon once it is adopted, constitutes an oversimplification of reality.

Donors usually provide gradual support based on the progress of reforms and the fulfillment of performance criteria. However, the latter will not necessarily be to the government's expectation, as they are not a mere set of measures. Instead, the state must prepare a roadmap for implementation, which is likely to encounter several hurdles, including the restructuring of debt and banks.

Furthermore, the state's calculations of foreign aid are highly far-fetched. The plan estimated the



government's needed support to be equivalent to \$28 billion over five years. Following the drop in the foreign exchange rate and bank restrictions on foreign transactions payment, it cannot be expected that the cumulative deficit will settle at this level. It is also likely that the debt service account will be slashed by half for the same reasons. The current account is expected to shrink by \$10 billion per annum, starting 2020. As such it will be difficult for Lebanon to secure the aforementioned amount in foreign aid, given its low quota at the IMF, amounting to only \$850 million (SDR633 million). Donor countries may not rely on the Lebanese state's estimations and its plan of providing foreign funding. Foreign funding estimations also take into consideration the country's total reserves which currently amounts to around \$14 billion (excluding gold), and its ability to service its foreign debt and its amortization.

Moreover, the CEDRE-related funding mentioned in the plan does not aim to restructure the debt and banking system, but rather to implement a development program. The plan further assumes that Lebanon cannot undertake a self-reform scheme, an unrealistic assumption, especially that the road towards reform is quite clear. The question then is why the Lebanese government is waiting for the IMF's approval. Lebanon undoubtedly harbors substantial potential that has not been utilized. Instead, the government resorted to foreign entities to chart the course towards reform, without realizing the cost of such interference, primarily in delaying reform until an agreement with donors has been reached.

FISCAL POLICIES

The Ministry of Finance devised most fiscal reform proposals in the plan, the most realistic of which are those that limit spending. However, it is recommended at this juncture that taxes be deferred until the economy recovers, while spending increases can be deferred and, consequently, could be decreased as a percent of GDP, with the exception of capital expenditures. Increasing, locally funded capital expenditures boosts economic growth. Likewise, resorting to funding through CEDRE requires local counterpart funding of at least 25 percent, which in turn calls for increasing locally funded capital spending, while the plan suggests otherwise.

The plan aims to bring Lebanon's financial deficit down to 1 percent by 2024. However, it is recommended that the country's public finance achieve a balance within a shorter period of time. A persisting financial deficit for another multi-year period (either the five years from 2020 to 24 in the

original plan or the three years from 2022 to 24) will weaken the state's current account balance and continue to put pressure on the exchange rate. It is unlikely that the plan will succeed in bridging the aforementioned deficit, while at the same time propose public wage increases, whereas the revenue outcome is uncertain.

DEBT RESTRUCTURING

The debt restructuring policy was not built on sound foundations, but rather consisted of defaulting on the payment of foreign currency (Eurobonds) in March 2020, and local currency debt, without consulting with local and international creditors. As a result, Lebanon's credit rating fell to junk, and private banks' finances were exhausted, making it increasingly difficult for the private sector to secure foreign funding.

The unilateral decision proposed by Lazard to deduct local debt has deepened the gap between the assets and liabilities of banks along with BDL. It undermined BDL's ability to continue implement-

ing its monetary policy of alleviating the pressure on the exchange rate. As such, the government's decision to default on its debt payments has contributed to the collapse of the currency, although at that time the BDL didn't support such a measure.

■ The plan misleads citizens into believing that deficits are substantial and cannot be resolved without external support

The Lebanese state was able to service debt until then. Defaulting on payment and classifying government bonds as distressed assets was an unsound measure and led to further economic collapse.

The state's compliance with the Lazard proposals, which suggested defaulting on payment, was devoid of logic and did not serve the public interest. The state had better service the due debt and then consult with financial institutions on debt restructuring, noting that international financial institutions' share of the debt in US dollars did not exceed \$5 billion until the end of February 2020, according to Bloomberg figures.

RESTRUCTURING THE FINANCIAL SECTOR

The scale of financial losses estimated by Lazard consisted of fictitious and overstated losses, which have primarily resulted from the state's unnecessary decision to default on debt payment. The reform program also called for deducting most of the principal of the local debt, to restore it to a sustainable level. Therefore, based on the default in

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payments, the government assumed that banks were bankrupt, rather than admit their own bankruptcy.

This uncalled-for decision led to an acceleration of the economy's regression, and deterioration in local and international trust. In fact, the aftermath has started to burden the predominantly poor, while claiming to protect them.

RESTRUCTURING THE CENTRAL BANK (BDL)

BDL's losses were inaccurately estimated and overstated. Pumping liquidity through seigniorage was BDL's response to the government's flawed fiscal policies, which exacerbated debt, increased interest rates, and contributed to the economic recession.

The government's decision to peg the Lebanese pound to the dollar has also played a role in this regard, leading to the subsidization of imports, causing acceleration of deficits in the Current Account. The plan, meanwhile, admits that seigniorage cannot be considered a loss. "Transfer of losses through seigniorage is a common practice widely practiced by central banks around the world during crises." (See: The Lebanese Government's Financial Recovery Plan, p. 40).

Why does the plan, then, assume that Lebanon's situation is different? Why are seigniorage costs considered as a loss of \$40 billion? The plan suggests these losses are the outcome of the Lebanese pound/US dollar peg policy, approved by successive cabinets to safeguard the currency exchange rate.

The government also assumed that the central bank was subjected to additional losses, resulting from Treasury bond holdings amounting to \$20.8 billion, raising the total losses to \$61.8 billion. The plan stipulates that compensating for these losses must come from bank deposits. In other words, both resident and non-resident Lebanese citizens have to absorb these losses along with bank deposits at BDL. And while the government's justification does not align with BDL's view, the latter reserves the right to ask the government to settle all dues, including deposits and bonds, which would be the right measure to take instead to having depositors and BDL carry the entire cost. The central bank can adopt this measure as it is an institution with an independent policy, while the funding provided to the Lebanese state exceeds the ceilings set forth by the Code of Money and Credit. As such, depositors (particularly non-resident ones) are willing to resort to legal measures, disabling the state both internally and externally, in case the government fails to carry its responsibility towards depleted banks' deposits at BDL.



RESTRUCTURING THE BANKS

Both the Lebanese Government's Financial Recovery Plan and the earlier Lazard plan assume that banks have incurred losses amounting to \$20.6 billion, for owning Lebanese State bonds, Eurobonds, and Lebanese pound bonds, as well as non-performing private sector loans. As such, the banking system's overall losses amounted to \$84 billion, according to Lazard calculations. The plan further assumes that the Lebanese economy will not recover unless banks are restructured, making all losses incumbent on bank depositors. Is liquidating banks the ultimate objective? The plan adds, "Authorities are convinced that law-abiding citizens should not bear the brunt of these measures." But where will the Lebanese state possibly acquire the bail-in sums needed for its law-abiding depositors?

Issuing licenses for new banks, as the plan suggests, is by no means easy at a time of economic recession. How would these banks secure deposits, especially foreign currency deposits? Therefore, it is recommended to coordinate and consult with the central bank, as it is directly responsible for issuing licenses and assessing the need for new banks.

CONCLUSION

The alleged losses of the banking and financial sector mentioned in the Lazard plan were fictitious. As mentioned earlier, seigniorage cannot be considered a loss, as it is the result of measures taken to secure monetary stability. Likewise, one cannot assume that some of the state's bonds now have no value (40 percent of state-issued bonds) and are considered total losses. Does this mean that the remaining bonds are of value?

The banks' actual losses only amount to 47 trillion Lebanese pounds (\$13.3 billion) and primar-

ily consist of private-sector loans. However, the net value of losses must be calculated, as most loans are approved against collaterals that compensate for such losses. The government predicts that it will be able to retrieve \$10 billion of looted funds over the next five years (See: The Lebanese Government's Financial Recovery Plan, p.32). If this is the case, why rush to secure foreign loans? After all, this is the sum needed to bridge the gap with foreign funding.

The plan also seeks to cover losses by deducting most of them from client deposits in banks, by resorting to a bail-out measures, and replacing deposits with bonds and assets in the Deposit Recovery Fund, the fate of which is uncertain. In principle, these measures fall short of a haircut and will cause an endless confrontation with depositors that could end tragically in total economic collapse. It is inevitable that many depositors will resort to local and international justice to resolve the issue.

On the other hand, establishing a Public Asset Management Company to compensate for deposit losses will not succeed in addressing the issue, as it will take decades to do so, while the state lacks the resources needed to manage it.

As such, the plan will likely yield the following outcomes:

- A continued drop of the Lebanese pound against the US dollar;
- Undermining trust in the banking system;
- Reducing consumption, production, and investment due to shrinking individual wealth;
- Discouraging foreign investment;
- Curbing foreign remittances;
- Increasing financial deficit; and
- Exacerbating poverty

The banking system will be unable to retrieve billions of dollars' worth of locally saved cash in foreign currency stashed outside banks.


Therefore, the agenda, which is extensively based on fictitious assumptions, will yield severe repercussions. It harbors unfair practices towards both wealthy and poor citizens, and seeks to destroy the Lebanese economy, oftentimes to the ignorance of those responsible for it. The plan was built on wrong foundations, including the alleged state bankruptcy, inflated foreign aid, and the assumption that Lebanon cannot overcome the crisis alone without dependence on the IMF.

According to Lazard, the IMF initially had a similar position, estimating that losses were tragic and called for an \$80.7 billion bail-in and a 79 per cent deduction from deposits.

From a financial standpoint, the plan misleads citizens into believing that deficits are substantial and cannot be resolved without external support.

The government can actually overcome obstacles and address the high demand on the US dollar through taking the following steps:

1. Fully unpegging the exchange rate and making all current transactions at the current market rate. In this context, BDL can be in charge of announcing the official rate on daily basis;
2. Liberalizing Current Account transactions;
3. Reducing the fiscal deficit to 1 percent of GDP by consolidating the state's debt in local currency at BDL and lifting subsidies on the electricity and other sectors. These two measures will secure over 6 trillion Lebanese pounds to the Lebanese Treasury;
4. Decreasing compulsory US dollar reserves on deposits;
5. Providing liquidity through the gold reserves, which falls under the competence of BDL pursuant to the Code of Money and Credit;
6. Liberalizing interest rates on all deposits immediately and allowing the restructuring of debt and deposits, under these exceptional circumstances;
7. Gradually transforming money supply into the local currency through trust-building measures.

As such, Lebanon's president, prime minister, and speaker must announce that the state is keen on preserving citizens' deposits in the deposited currency, and that compromising the deposits of residents and non-residents is a breach of the Lebanese constitution and a threat to civil security. The very mention of the term "haircut" has terrified Lebanese citizens whether locally or abroad, noting that an important share of deposits belongs to the Lebanese diaspora. 

Mounir Rached, PhD, is the president of the Lebanese Economic Association (LEA) and a former IMF Senior Economist (1983-2007).

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A FISCAL SPACE TO BREATHE



Hits and misses of the Lebanese government's financial recovery plan

In its efforts to address the grim situation that the economy and financial system are in, the Government of Lebanon published in April 2020 a financial recovery plan¹ aimed at restoring confidence and putting the country back on a long term sustainable path. Most importantly, the program pointed at forcefully addressing “fiscal and financial imbalances” – the main pillars of the scheme that has fueled Lebanon’s downfall. These imbalances were addressed within one of the nine central headlines targeted at fiscal adjustment and focused on improving tax compliance, streamlining expenditures, and reforming the public sector.

Unfortunately, the government failed to embark on immediate reforms to create fiscal space and support existing social safety nets despite the impact of the compounded crises falling hardest on the poor and vulnerable. As such, this article ad-

dresses the need and means to create this space and prioritize a set of actions from within the proposed reform pillars stipulated in the government’s plan.

As a result of the multiple crises, particularly during the last two years, Lebanon’s GDP dropped to around \$20 billion, and the UN-ESCWA report on multidimensional poverty in Lebanon (2019-2021)² stated that poverty almost doubled from 42 percent in 2019 to 82 percent in 2021, with nearly four million people facing deprivation in education, healthcare, public utilities, housing, assets, employment and income.

These alarming figures, coupled with rising inflation rates and the ongoing depreciation of the local currency, have exacerbated already existing vulnerabilities and exerted further pressure on the Lebanese people who are facing dire shortages in food, medicine, and fuel.

THE MEDIUM-TERM FISCAL STRATEGY AT A GLANCE

To reduce the country's fiscal deficit that had exceeded 10 percent of GDP at the end of 2020, the recovery plan stressed on the need to re-evaluate the state's fiscal policy and define a clear set of targets or "golden rules" on which future budgets need to be based.

Several corrective measures were proposed – at the level of expenditures and revenues – geared toward creating a primary surplus by mainly cutting off wasteful spending and enhancing tax revenues. These proposals include, but are not limited to, increasing budgetary revenues by curbing tax fraud and evasion, improving the compliance rate, and revamping the entire tax system.

At the level of expenditures, proposals tackle the need to build spending priorities on the basis of clear criteria that meet the economic, social, and financial needs of the country such as controlling the public sector wage bill, addressing the hefty pension scheme, limiting transfers to Electricité du Liban, and reducing transfers to and financing of state-owned enterprises, agencies, and funds.

Despite the importance and inevitability of all these reform pillars to achieve the government's fiscal objectives, it is essential to recognize the fact that the majority require a relatively long process and, in many cases, the adoption of a set of reform laws. As such, most of them cannot yield a much needed immediate impact.

FISCAL SPACE CAN EXIST

Sad to say, the social component in the program does not address the severity of the situation in the country. Despite surging poverty rates, the plan merely focused on support provided by international organizations (i.e., the World Bank) without realizing the importance of prioritizing many of the proposed corrective measures to create fiscal space.

Fiscal space is normally defined as the government's ability to confidently use the available room in its budget without risking any unfavorable impact on its financial position or the economy's stability.

The reality is that Lebanon has no fiscal space. The country's financial position and economic stability are already jeopardized; however, this does not deny the importance of looking at readily-available options to be implemented.

Delving deeper into these alternatives, the main

titles of re-prioritizing expenditures and increasing tax revenues top the list. In terms of spending, the government should immediately opt to implement the plan aimed at addressing the ineffectiveness of many of the 73 public entities by "merging entities when feasible, reigning salaries and benefits, and rationalizing operational costs, while closing

other obsolete entities and eliminating redundancies when deemed relevant." Accordingly to a recent report by Institut des Finances Basil Fuleihan³, despite there being many revenue-generating State Owned Enterprises (SOEs), others constitute a liability to the State.

■ Quick-wins lie in increasing taxes on luxury goods and improving tax collection by first closing illegal crossings and fighting smuggling

Lebanon's classified off-budget spending is equivalent to more than 16 percent of total budget with large SOEs operating outside of it, and managing substantial amounts of public funds that are not submitted to the legislature's approval, or reported into consolidated data.

At the level of revenues, quick-wins lie in increasing taxes on luxury goods and improving tax collection by first closing illegal crossings and fighting smuggling, and enforcing fines on projects illegally built on public domain maritime and other sites. The occupancy of these large properties, whether licensed or not, fails to bring in the revenues corresponding to the value of the occupied areas mainly due to failure in collection. According to figures from previous draft budget laws since 2017, the average expected revenues amount to roughly \$100 million.

These decisions do not only address inefficiencies and complement the government's efforts in building fiscal resilience, but also support the already existing and weak social safety net program in adapting to the major economic downturn that the country is witnessing.

REALLOCATE SPENDING FOR A BETTER SOCIAL SAFETY NET SYSTEM

According to International Labor Organization (ILO) 2019 figures, Lebanon spends around 13.8 percent of its GDP, and 30 percent of its public expenditures on social protection. Unfortunately, social coverage remains among the lowest and most inequitable.⁴

That being said, and given the recent removal

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■ The reality is that Lebanon has no fiscal space. The country's financial position and economy's stability are already jeopardized

of subsidies that have long crowded out social spending, the reallocation and reprioritization of existing government spending has become unavoidable. This re-arrangement in fact feeds into expanding the budget allocated for the existing social safety net program (i.e., the National Poverty Targeting Program) in efforts of building a comprehensive system that is catered to the poor and the vulnerable Lebanese.

While the World Bank funded Emergency Social Safety Net (ESSN) and the foreseen Broad Coverage Cash Transfer (BCCT) programs can address the situation, they remain temporary solutions to all of Lebanon's woes – a truth that further justifies the necessity of creating fiscal space that is able to provide a longer term solution in anticipation of the government reaching an agreement with the International Monetary Fund.

However, it is worth noting that the support provided by the World Bank in terms of financing and the development of social safety net registries and databases would prove crucial to capture current and future vulnerabilities and would allow Lebanon's current social safety net program to scale up and expand its coverage successfully in the future.

THE NEED TO ACT NOW

While many of the deeply rooted structural problems require medium- to long-term actions, the government must act immediately when addressing social issues and related policy responses by at least trying to implement one of the reform pillars they initially suggested in the recovery plan.

People are in the heart of the storm, and unless the latter's impact is mitigated, the situation will remain a ticking social bomb. ■

Rayane Dandache is an economic policy expert

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NO WAY OUT?



The debt that consumed Lebanon

The Lebanese national debt, seen in relation to the country's GDP, has been one of the highest in the world for many years. When the cost of servicing that debt became extreme and international investors lost faith in the country's ability to manage its finances, it was inevitable for the whole financial system to crash. Generations of savings by Lebanese residents and non-residents evaporated through high exposure of banks and the BDL to the sovereign risk. Getting out of the debt trap requires drastic measures.

Sovereign debt defaults have been part of the modern world's economy for centuries; some de-

faults are even traced back to the fourth century in Greece. Countries choose certain economic, fiscal and monetary policies that put them at risk, and when adverse events occur over a relatively short period of time, the system endures a distress that mostly ends in a financial and economic crisis. The risky policies usually involve overspending by a government, leading it to borrow more. The consequence of this is higher interest rates to compensate for the increased risk, which, if not reversed with economic growth in time, leads to a spiral of risk that threatens the government's finances and the national currency.

LIKE A HELL-BROTH BOIL AND BUBBLE

Lebanon treasury finances were always in deficit and mostly in Lebanese pounds. A large and constant inflow of dollars from remittances, personal capital flows, and – in some years – tourism, helped contain the risk of expansion in Lebanese pound debt.

However, Lebanon's dollar borrowing to fund the deliberately failed electricity company, *Electricité du Liban* (EDL) and the interest on dollar debt, meant that every new dollar borrowed locally translated into a Lebanese depositor's dollar wasted. By the end of 2019, the interest expense of the Lebanese government had reached 65 percent of its total revenues.

Lebanon's last Eurobond market issuance was in 2017, which has been interpreted as a signal that no one wanted to hold Lebanese Eurobonds because it was clear to investors worldwide that the Lebanese debt had crossed its point of sustainability. By the time the crisis reached its peak, out of the \$120 billion in depositors' money, \$20 billion had been borrowed by the government and \$80 billion was classified as reserves by BDL but committed under financial engineering. The government policy of pegging the Lebanese pound to the dollar artificially overvalued the currency and depleted deposits.

The Lebanese national debt reached 174 percent of GDP towards the end of 2019 and two years later, at time of this writing, stands at 210 percent at market rates. The envisioned restructuring of the debt would now involve a haircut of 60 percent to make it sustainable, which would have been equivalent to a haircut of around 50 percent on depositors in 2020. This was considered the best case scenario by some in 2020 when the government issued its ill-fated recovery plan. However, the plan was never adopted, and the BDL monetary policy intervention continued, opting to inflate the system by printing trillions of Lebanese pounds, thereby rendering people's deposits partially worthless.

Any restructuring that would be imposed would still need to haircut depositors, but these depositors would be much poorer now, given the spiral of inflation and devaluation of the Lebanese pound.

LIFTING THE CURSE?


For the debt to be sustainable in the coming decade, its cost has to be contained. For the Treasury to

afford the interest on the newly restructured debt, it needs to be able to collect taxes again from a functioning economy. For the central bank to be able to pay back its debt to the banks and hence to depositors, it needs to replenish the dollar reserves. Therefore, the solution to the debt is an economic, fiscal, and monetary one.

Unless there is a holistic approach to the Lebanese

crisis, the country would risk being subject to multiple defaults over the next two to three decades, with increased poverty and no cumulative wealth, rendering the country one of the poorest in the world.

The restructuring of the dollar debt requires an international bailout. The restructuring of the Lebanese pound debt is important to keep the cost of debt low. It is nonsense that the large portion of the debt which is denominated in Lebanese lira is not a threat anymore because its value, in terms of dollars, has shrunk and is continuing to shrink. But lira-denominated debt is payable in lira, from lira revenues. Indeed, the only fiscal revenues that could be used to pay this debt, as all fiscal revenues of the finance ministry in Beirut, are lira revenues; hence the 3 trillion Lebanese pounds in payable interest on this debt still hold.

In such a severe recession as currently experienced by the Lebanese economy, one cannot expect to collect more money from existing taxes or hike tax rates; the focus should be on increasing the productivity of the Lebanese economy and supporting export-oriented sectors. One time-honored idea for boosting productivity is to invest in needed infrastructures, and once the international community was standing by to inject those billions of dollars in infrastructure projects that would boost the economy and support the fiscal and monetary policies. But alas, we missed that opportunity and we now seem to be on our own – and we all know what that means. 

Salim Taha is an economist specialized in public finance

THE ROAD THAT WAS NEVER TAKEN

Lebanon's fiscal reform

The definition of reform in the dictionary is “making changes to something in order to improve it.” It seems the fiscal situation in Lebanon has reached a point where no amount of changes can improve it. The challenge has become insurmountable and the country's finances might fall into a permanent failure trap that might persist for many years.

Let's look into the major categories of revenues and expenditures historically in Lebanon.

State treasury revenues are generated, in order, by income taxes, value-added tax (VAT), state owned enterprises (SOEs), customs and excises, and real estate registration.

DOWN & DOWN

All treasury revenues in Lebanon were collected at levels far below their optimal level due to endemic corruption; corporates and individuals rarely declared the right level of their income or real estate transactions. Customs and excises generated approximately half of the expected revenues, the VAT revenue gap escalated. Profitable SOEs such as Middle East Airlines (MEA), Beirut's port and airport, Casino du Liban, the Régie, Electricite du Liban (EDL), and telecom operators were over-staffed and mismanaged. Heavenly loss making Electricite du Liban of course was worse reputed to say the least.

The Lebanese economy is estimated to have shrunk by around 40 percent in the past two years and is going through one of the most complex and dire crises in history. For the same reasons that treasury revenues were under collected, reasons which are being newly exacerbated by the shrinking of the economy, the erosion of purchasing power and increase in poverty, the finances of the Lebanese government in the coming years will be a fraction of what they used to be. In dollars, at the now-deceased official exchange rate, revenues were around \$10 billion during the beginning of the collapse which really started in 2016 and was artificially postponed by the “financial engineering” undertaken by the Lebanese central bank, Banque du Liban (BDL), at a very



high cost. In the first five months of 2021, according to the latest published figures by the Ministry of Finance, the treasury collected 6,658 billion lira, the equivalent of \$246 million at the closing black market rate of 2021 (27,000 Lebanese pounds (LBP)/\$1). Extrapolated to a full year, this means the revenues would reach around \$590 million, or 6 percent of what they used to be in dollars.

IN A SORRY STATE

On the expenditures side, the highest categories are occupied by personnel costs at the top, with debt interest payments coming in at a very close second, followed by subsidies to Electricité Du Liban (EDL), then capital expenditures (capex), then municipalities. An overly bloated government with some 300,000 employees on the payroll between active duty and retired staff (no one really knows the exact figure), where clientelism has always been the name of the game, is not expected to fire anyone anytime soon. End-of-service and pension payments were already unsustainable before the crisis, and printing more Lebanese pound notes to keep them up will only make things worse. Transfers to EDL shrunk by half between 2018 and 2020 due to lack of funds, not to mention the absence of reforms. This has translated as reduced deficit but more blackouts, higher costs on households to substitute increasing blackouts with generators, increased pollution, and less economic productivity. Capex was zero in 2019 and 2020, which means even the small amount of spending on maintaining the minimum infrastructure – post obscene profits margins that had been granted to politically affiliated contractors – is not available, which will only make the country more unlivable, and require much more investment in the future to rebuild it.

As for the interest on debt, following the default decision on Lebanon's external debt (Eurobonds), billions of dollars in depositors' funds, in principal and interest, must be factored in with a proper debt restructuring agreement with investors. The restructuring will not be feasible without an International Monetary Fund (IMF) program, which will not materialize without fiscal reforms.

But given the clear unwillingness of the political godfathers of the system to reform anything, the country and its government are expected to remain in a zombie state. This means the treasury, with its miniscule revenues and expenditures in real value, will artificially be kept alive with additional printing of Lebanese pound notes, creating a spiral effect of devaluation/inflation/poverty/negative growth, which can go on for a long time.

SUCCESSION PLANNING?

You are probably wondering by now what the solution might be. Well, the official answer to that is: reform public service, restructure debt, restructure

■ The treasury [...] will artificially be kept alive with additional printing of Lebanese pound notes, creating a spiral effect of devaluation/inflation/poverty/negative growth

the banks, restructure the state-owned enterprises, take money from the IMF and rebuild the economy hoping to get back to pre-2019 GDP levels in 15 years. Here you go, la vie est belle.

Is that a realistic scenario? When companies fail, the first thing that bankruptcy administrators do is change the management. A whole country failed and is witnessing the largest exodus of human capital since its civil war 40 years ago, but the managers are still the same. Until the managers are changed, one way or another, we should expect Lebanon to become a small, poor and failed economy, surviving indefinitely on a few billion dollars in net remittances. ■

Salim Taha is an economist specialized in public finance

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WAITING FOR GODOT



The ongoing failure of even trying to save the Lebanese pound

More than 120 countries in the world have some form of a pegged exchanged rate system, in either soft or hard pegs mainly to the US dollar or the euro. Small economies benefit from pegging their currencies to reduce macroeconomic volatility and improve predictability for investors and visitors of the country.

LEANING TOWER OF LIRA

The Lebanese pound before the civil war benefited from a period of floating exchange rate system driven by strong influx of dollars from tourism and banking. During the civil war, political

money took over remittances and tourism and capital flows, and these murky funds of conflict finance were the only source of foreign currency. In 1987, the Lebanese pound witnessed its biggest crash ever with a devaluation in excess of 400 percent in less than two years, crossing 800 Lebanese Pounds to the dollar. When the Lebanese pound was pegged to the dollar at the end of 1992 and settled at 1,507.5 Lebanese pounds/\$1 in 1997, Lebanon had a lot to benefit from exchange rate stability and predictability.

Pegged exchange rate systems require adjustments over time when macroeconomic features

of a country witness a change. Countries with free capital flows and fixed exchange rate lose monetary policy autonomy, a concept known as the impossible triemmma. For Lebanon, this means that to maintain stability in Lebanese pounds and free movement of capital, the Lebanese central bank, Banque du Liban (BDL), has to follow interest rate movements in the base currency (USD in this case) plus a certain risk premium, otherwise capital would exit the country.

At the onset of the Syrian civil war, the Lebanese pound was already suffering from an overvaluation due to dollar inflows to the economy from Lebanese expatriates, which were not channeled to the productive sectors in the economy but rather to bank accounts offering high interest rates. This rendered price levels in the services industry very high, a concept known as an increase in the value of non-tradable goods and services in a Dutch disease scenario. Simply compare the cost of a hotel room in Lebanon in US dollars in 2010 vs. 2021. A gradual adjustment of the soft peg's 1,507.5 rate was long overdue.

REPERCUSSIONS OF FINANCIAL ENGINEERING

In the past decade, remittances, personal capital flows and tourism income declined gradually due to regional instabilities and a host of adverse factors, leading to an erosion in the balance of payment surpluses of the previous decade. Resorting to unconventional monetary policies led to a search of interest rates offered to large ticket-depositors. The Lebanese government failed to induce reforms that were requisite to receiving CEDRE funds. For instance, if interest on deposits in Lebanese pounds had to be raised above 10 percent to attract inflows, depositors collecting that interest should not have been allowed to exchange it for dollars and then transfer this profit abroad because they would effectively have been taking someone else's dollar deposits. The government failed to deliver promised reforms expected by Riad Salameh, some of which include infrastructure investments, consequently losing a chance at receiving CEDRE money.

Following the crisis, further depletion of BDL reserves was caused by subsidies of essential and some non-essential imports and further capital flight by those powerful enough to manage it. Now the economy has multiple exchange rates operating at the same time, three official rates for the Leba-

nese pound to the dollar (1,507.5; 8,000; 12,000) and one market rate. The real market rate, standing at around 27,000 Lebanese pounds/\$1 at the time of writing this article, will always be ahead of any official rate as long as there are no proper macro-economic measures being taken. BDL claims to have only around \$14 billion of depositors' money left in its reserves. Where will the Lebanese Pound go from here?

MILLION-POUND CHICKEN DINNER

The devaluation of the Lebanese Pound technically has no limit; with the vicious cycle of inflation and devaluation, the Venezuelan Bolivar reached such a devaluation in 2018 that it would have been cheaper to use the currency as toilet paper rather than buy toilet paper with it. Will the Lebanese pound get there? Maybe not to that extent, because a few billion dollars of remittances are still coming

in every year from expatriates who support their families. However, Lebanon is highly dependent on imports, especially for its energy needs, which means that reserves will continue to be exhausted for the operation of the economy. The first step to halt degradation is confidence. When a government was formed in

■ Banque du Liban (BDL) has to follow interest rate movements in the base currency (the US dollar in this case) plus a certain risk premium, otherwise capital would exit the country

September 2021, the Lebanese pound appreciated to 14,000 Lebanese Pounds/\$1. It has halved since then because literally no action was taken yet to save the country from one of the worse crises in history.

Prime Minister Najib Mikati and a host of analysts are still debating about the losses of the financial system two years after the crash while depositors' purchasing power is evaporating by the minute. Let us hope they conclude their argument before the cost of a chicken reaches 1,000,000 Lebanese pounds. It is to be hoped that before then, they would have restructured the central bank, the financial system, and the public sector, then designed the right macroeconomic policies that provide confidence so the very long recovery can begin. Should we wait for that, or would waiting for Godot be less painful? ■

Ali Hamieh is an economist specialized in public finance

AN ECONOMIST'S REVIEW OF THE 2022 BUDGET



No vision, no reforms, no money

The Budget draft law for 2022 that has been submitted to the Council of Ministers, projects 55.2 trillion Lebanese pounds in expenditures with revenues of 39.1 trillion. The need for a 2022 Budget is required to sanction spending and its approval by the cabinet has been a precondition for negotiations with the International Monetary Fund.

However, the Budget of 2022 reveals most disturbingly, the absence of any profound and comprehensive reforms. It is merely a continuation of past policies with an inflation adjusted factor. The Budget does not state objectives for growth, an inflation target and the balance of payments, nor how it can contribute to resolving the crisis.

FIRST DISTURBING SIGN: MULTIPLE FIXED EXCHANGE RATES

The continued provision of applying multiple fixed exchange rates under the 2022 Budget is by itself a setback for reform. A regime of multiple currency exchange rates (MCR) is not only unjust but an infringement of the constitution. It exhibits the intention to gradually deplete banks of a substantive amount of deposits to reduce their losses at the central bank, Banque du Liban (BDL). Either the intentions of the government and BDL are being concealed or it is not understood that fixed rates constitute a large loss for depositors and for the economy. Actually, it was this multiple rate policy that has in recent years completely eroded the lit-

tle remaining trust and confidence in the management of the system.

The frequently stated excuse that unifying and liberalizing the exchange rate is inflationary is a false argument. To the contrary, the current multiple rate policy has the ingredients for a continued decline in the parallel (free) exchange rate and persistence of inflation. The free unified market rate leads to equilibrating the financial markets – and allows depositors to regain the value of their dollar deposits and absorb their LBP deposit losses.

Given that many banks are being influenced/controlled by the political elite that is involved in Budget law decisions, it's not surprising that the Budget draft law prescribes a multiple rate system. However, the fixed and multiple exchange rate policy that is being sponsored is very likely to preclude reaching an agreement with the IMF that has been all along preaching freeing the exchange rate – a staunch policy of the IMF.

While the persistence of a multiple rate system proposition is void of reform intentions, the central bank's unsustainable currency intervention to prop up banks seems designed to provide a false signal that reform is coming. The fact that BDL has been able to convert most of its SDR holdings into a reserve currency (probably a gesture from a friendly economy) does not change the fact that this intervention in the exchange market has been facilitated temporarily.

THE SECOND WORRYING SIGNAL

Apart from the draft's stipulation for continued multiple exchange rate practices, the Budget in its current draft also does not show intent for serious reform; it is rather a collection of fragmented measures of tax rates, excises and spending.

Total spending in the Budget surpasses LBP 55 trillion, including the credit extended to Electricite du Liban. Support to EDL cannot be classified as a loan (and thus excluded from budget spending) because the utility is unable to pay back its existing loans that have exceeded \$ 20 billion. Fiscal support of EDL is a subsidy, was classified as such and included in spending for many years. Even the case of a loan was to be made, the budgeted expenditure should be classified as an increase in acquiring non-financial assets, and the counterpart classified as an increase in financial assets in financing (a loan) of the Budget; thus increasing the deficit and increasing the financing needs by an additional LBP 5.2 trillion.

Another notable Budget item relates to wages and salaries, where an expenditure increase of a full month salary is stipulated in addition to increased transportation support. Counter to a standard recipe for administrative and fiscal reforms, the Budget fails to reveal any structural reform in the civil service. The apparent preference is to retain a

■ The fixed and multiple exchange rate policy is very likely to preclude reaching an agreement with the IMF that has been all along preaching of freeing the exchange rate - a staunch policy of the IMF.

large civil service body which is much larger than that of any peer country. In summary of the 2022 Budget, its current components are dominated by wages and salaries (12.3 percent), civil servants' benefits (16.6 percent), EDL subsidies (10 percent), and domestic and foreign debt service cost (13.8 percent combined).

Also, notably, in the context of analyzing the Budget, the allocation of LBP 9.2 trillion to civil servants includes LBP 7.0 trillion of social spending allocated to government employees without providing a clearly defined purpose. For both domestic and international debt service interest payment, it's not specified whether these amounts are based on a debt rescheduling agreements or not. The capital Budget on the other hand remains low at 4% of total spending and is not growth oriented.

MAIN EXPENDITURES UNDER 2022 BUDGET DRAFT (*in trillion LBP*)

Wages and salaries	6.8
Retirees' compensation	3.6
Social allocations for civil servants	9.2
Domestic debt service	6.4
Foreign debt service	1.2
EDL subsidies	5.2
Other spending	11.4
Reserves	9.2
Capital spending	2.2
Total	55.2

Financial Economy

THE REVENUES

Revenues, however, add up only to LBP 39 trillion. This side of the fiscal plan reflects primarily tax increases on interest earned to 10 percent (from 7 percent in the previous budgets), and hikes in the tax rate on wage incomes where the new maximum rate is 25 percent on upper income brackets (from 21 percent), and wage bracket increases for all tax rate ranges. In addition, revenues are assumed to improve on basis of increased customs rates in combination with the new exchange rate applied on customs receipts. Depending on what exchange rate is used, the imposition of a new customs regime could lead to customs increases – with the real size of the increase depending on how the market reacts to these changes.

A full exemption from tax on interest is introduced on new dollar deposits for 5 years from the time of approval of this Budget law. Other tax relief measures include rescheduling of due taxes and excises for a three-year period, resettling of VAT and income tax arrears on large tax payers, and transferring losses one year forward.

The beneficial effects of the proposed tax relief measures and hiking of customs levies are highly uncertain. The tax exemption on fresh dollar deposits is unlikely to attract financial inflows as the risk factors remain dominant in repelling inflows. The proposal to set a broad 3 percent customs rate on most imports may incur a conflict with trade partners who can demand adherence to existing trade protocols. The same issue may arise with applying a 10 percent customs rate on imports for which domestic substitutes exist. The Budget revenue draft thus represents an inward-looking approach to trade.

The main observation of revenue items in the 2022 Budget is that indirect taxes (which are regressive) dominate the picture. VAT is the largest source of revenue. Adding in fees and charges on trade, indirect taxes on goods and services are the largest source of government receipts at 50.3 percent of all fiscal income.

The Budget is attempting to generate revenues in foreign currencies by stipulating that wage taxes should be based on the currency that salaries and other receipts are paid in. The

■ The Budget of 2022 reveals most disturbingly the absence of any profound and comprehensive reforms.

same principle could be applied to other sources of income but with a high danger that such a policy will raise public opposition and at the same time see as justification for using foreign currencies as a local legal tender.

The Ministry of Finance (MoF) is, surprisingly, being given a discretionary power to set the exchange rate for the purpose of collecting customs and VAT on imports, and other taxes. This implies a continued absence of transparency, as no basis for such decisions has been provided in the draft law. In addition, the policy in the current budget gives the MoF the discretionary power of determining certain tax exemptions and discounts on un-specified income taxes and fees.

The 2022 Budget draft law, reviewed here before its finalization by the Council of Ministers, is subject to debate and approval by the Lebanese Parliament. Many details will be discussed and adjusted. However, there are many fundamental questions that are not addressed in the draft and remain to be answered. The people of Lebanon have the right to receive answers on two fundamental issues on which the current draft is silent, namely the question of how the budgeted deficit of nearly LBP 15.4 trillion could be financed and the equally important question further to what extent the budget is in compliance with IMF demands.

These are vital questions that could make the start of Lebanon's long journey of rebuilding the economy more tenuous. In addition to the strategy for economic recovery and the faith of public deposits, is there consistency between the recovery plan and the budget? Furthermore, the question on every economist's mind relates to the sources

MAIN REVENUES UNDER 2022 BUDGET DRAFT (in trillion LBP)

Income taxes	5.9
Property taxes	2.9
Taxes on goods & services	19.7
Tax on international trade	3.4
Non-tax revenues	5.5
Other tax revenues	1.6
Total	39.1


BUDGET 2022: MISSING THE POINT

In consequence of my analysis of the 2022 Budget draft law, I have identified a very long list of key issues and several important questions that need to be addressed:

ISSUES:

- The crisis was caused by the absence of fiscal discipline. The Budget reveals a continuation of same past policies with a large deficit of 31% of spending.
- The Budget needs foreign financing as well, at least for the subsidy to EDL. In the absence of any potential access to international markets, the government option is to finance its need of foreign exchange from the domestic market with serious repercussions on the parallel rate and the disparity between the fixed and the free rate.
- Neither Eurobond interest cost and principal arrears nor the issue of default with holders is addressed. All arrears should be reflected in the Budget so that debt accumulation resulting from default be properly reflected.
- The Budget is attempting to generate revenues in foreign currencies by stipulating that taxes should be based on the currency that salaries are paid in. This could be a constitutional infringement.
- The fiscal stance does not address when access to deposits (dollar and LBP) could be liberated.
- The NSSF is facing a major challenge in being unable to pay back retirees' indemnity as it holds most of its reserves in T Bills, in addition to the loss of the real values of these amounts. There is no action plan in this regard except the proposal to pay government accumulated arrears to NSSF over a 10- year period. This stance is certainly not in favor of retirees, knowing that the value of their end-of-service entitlements gets significantly diluted.
- BDL losses due to government overspending (out-right foreign currency over-drafts) and BDL holding of government debt, in Eurobonds, in T-Bills and direct credit, are not addressed.
- Subsidies to EDL remain large, about 10 percent of the Budget.
- The Budget does not address any measures to improve the performance of the public sector, and electricity in particular.
- Any fiscal and quasi fiscal financing has to be revealed in the Budget (excluding IMF financing as it is considered credit to the BDL), which is not the case.
- Taxes are mostly indirect and regressive, and don't provide for equity improvement. VAT alone is about 30 percent of revenues. Indirect taxes as a whole constitute over 50 percent of total revenue.
- Tax measures on imports could be controversial as they may violate trade arrangements. The Budget proposes an arbitrary customs rate of a 10 percent and a 3 percent flat rate on all imports, excluding fuel imports
- The exchange rate is defined in an arbitrary way by the MoF, which could be unsettling for the financial markets and traders.
- Discretionary powers are to be granted to the MoF for setting the exchange rate for trade transactions, in particular, and discounts on tax arrears. These measures raise the issue of compliance with the constitution.
- Immediate action is needed to liberalize the exchange rate. The government didn't provide any clarification on its position yet.
- Domiciliation of salaries can't be applied while the BDL continues to stipulate limits on withdrawals. It assumes that acceptance of the Lebanese pound as a legal tender is violated.
- Rescheduling of public debt is not addressed.
- The social safety net plan is absent from the Budget.
- The urgent need for better governance and the problem of rampant corruption are not addressed.

of financing the Budget, and yet ignores the losses of people's savings through the banking system and its holding of T- bills and Eurobonds. Thus we need to know: does the domestic market (banks and non-banks) have the will to provide financing to the government? By my understanding this is very doubtful. We also ask: is there any intention

to compensate, at least partially, depositors for the losses linked to bank-held T- bills and Eurobonds? The Budget cannot remain silent on this. 

Mounir Rached, PhD, is the president of the Lebanese Economic Association (LEA) and a former IMF Senior Economist (1983-2007).

FREE ZONES IN LEBANON... MORE THAN A NEED... A NECESSITY

An analytical study of the free zones and their role
in achieving urban development

By Firas El Husseini



Most countries in the world seek to attract investments as a dynamic driver of their economies. The establishment of free zones is one of the factors that countries, especially developing countries, resort to in order to attract and encourage foreign and national investments, due to the facilities and privileges offered by these areas such as tax and customs incentives and relatively cheap labor that enables investing companies to increase competitiveness and thus achieving a higher ROI (return on investment). The increase in the number of free zones in various countries of the world is one of the phenomena that caught the attention of researchers and specialized economic scholars to look for the motives and effects of these areas and the possibility of economic progress for the country that established them.

In the case of Lebanon, with the deteriorating economic situation that the country has never witnessed before in its history, the need is crucial for elements enabling the economy to restructure itself from within, instead of banking on the international community and entities to come up with a plan of action for the Lebanese to implement; with an appropriate vision and the decision taken, the country can regain its previous status as the Switzerland of the East.

A FLASHBACK ON FREE ZONES

Since the time when the concept of free zones emerged, it was intended to attract part of the volume of international trade. Historically, the idea of free zones dates back to about two thousand years ago, since the era of the Roman Empire. It was the first region in the Aegean Sea, where the free Delos were known islands that applied the idea of re-shipment, storage and re-export of goods crossing the borders of the empire.

The countries located in the Mediterranean basin depended on commercial activity using the system of free zones in the Middle Ages, and with the emergence of colonies, European countries established small areas for them in cities with ports to facilitate the movement of trade between Europe and its colonies. Examples of the free zones that were established in that period are the Gibraltar region 1704, Singapore 1819 and Hong Kong 1842. These regions practiced re-export activities, providing shipping and establishing special warehouses for that. With the second half of the 19th century and the beginning of the 20th century,

the idea of free ports began to grow rapidly in Europe, and after the Second World War, when international trade began to grow again at a rapid pace in important strategic locations on the international trade lines, and the predominant use of free zones at this

time was in the form of storage and re-export centers.

One of the successful examples of free zones during this period is the Colon region in Panama and in the late fifties and early sixties a new form of commercial free zones began to emerge that does not depend on commercial activity only, but depends on export industries, that is, it is part of the attraction planning for the international investment flows to industrial investment in the host country.

The Shannon free zone in 1959 began to change the prevailing pattern of commercial free zones in the world from commercial activity to industrial activity, as it focused on establishing industrial projects that could absorb large numbers of workers and focused on the country's exports to the outside world. During the sixties and the beginning of the seventies, several countries began to endorse the idea of establishing industrial export zones in order to create an advanced export sector in those areas. Examples of the free zones that the Philippines and Bataan established in this period are: Bataan Malaysia, as well as Bayan Lepas and Japan Masan. Some countries have established free zones to serve both goals at the same time, to be free commercial and industrial zones, like the Egyptian free zones. Free zones have developed over time and the nature of their work has evolved. Export free zones for "exports" represent at the present time the prevailing pattern of free zones. According to the Kiel institute for the world economy, there are more

**"Direct job positions
were estimated at
26,000 jobs in Jbeil"**

than 5,000 Special Economic Zones worldwide, and the trend is rising, while the OECD (The Organisation for Economic Co-operation and Development) states that the so-called Free Zones are responsible for exports worth at least 3,500 billion a year, equivalent to around 20 percent of global trade in goods.

THE CONCEPT OF FREE ZONES BY DEFINITION

Considering the various legislations regulating the work in free zones around the world, we find that they did not set a specific definition of a free zone, but rather set a specification for its boundaries or for the customs' procedures and regulations under which the system works within such areas, and some have designated the fields of activity that can be practiced within its boundaries. As the definitions varied according to the different "political, social and economic" goals in each country, those zones have developed along with the development of the nature of activities therein. They are a form of national and foreign investment; and from the customs' viewpoint, they are considered an extension of the outside, but they are subject to national sovereignty from the political point of view.

Some define the free zone in a simplified definition as "the part of the state's territory in which commercial, industrial and current operations are allowed in between countries free from customs, import and export restrictions and cash, hence the name free zone", and it is "the closed space under guard where goods are stored, whether they are that space in a sea or airport, inland or on the coast, where goods of foreign origin are received with the intention of re-export, display, or the introduction of some additional operations therein.

THE CONCEPT OF FREE ZONES BY OBJECTIVES

By establishing free zones in their territories, the host countries aim to achieve one or more of the following objectives:

- 1- Establishing industrial productive projects whose main objective is export.
- 2- Increasing the country's foreign exchange earnings.
- 3- Establishing productive projects that meet the needs of local consumption instead of imports for both consumer and producer of goods.
- 4- Attracting foreign capital, which brings with it modern technologies in production and management.
- 5- Contribute to the revitalization of the internal and external trade movement.
- 6- Reducing the problem of population pressure in some large cities.
- 7- Reconstruction and development of some regions or increasing the urban growth of some relatively backward regions in order to find a kind of social and economic balance between them.
- 8- Finding and creating new employment opportunities, raising the level of technical and administrative skills, including modern technical knowledge and advanced technology developed by the free zone projects, and reducing the problem of unemployment.
- 9 - Attracting backward integration projects and creating forward linkages with the two sectors of the local economy, industrial and commercial.
- 10- Increasing the national income and redistributing it, increasing the net capital formation and bridging the gap between saving and investment.

BYBLOS AND THE BEQAA VALLEY: TWO LOCATIONS... TWO HUBBS

Establishing two free zones, one in Byblos (Ibeil) and another in the Beqaa Valley is one of the key measures if one can foresee the opportunities in these two locations.

Mostly, the expected positive effects if such a project takes place can be summarized in the following points:

- 1- **Employment: direct job opportunities can be created through companies and institutions investing within the region and indirectly, due to the backend links with the national economy. Direct job positions were estimated at 26,000 jobs in Ibeil (20% of 130K inhabitants).**
- 2- **Increasing the inflow of foreign currencies, the source of which is the wages paid to workers.**
- 3- **The rent value of buildings, land, electricity, gas and communications.**
- 4- **Importing raw materials, equipment and all projects' needs from the local markets, pre-determined at a certain rate (most of the countries adopt the 20% rate).**
- 5- **Integrating the production of national institutions with the production of local institutions.**
- 6- **The development and sustainability of services.**
- 7- **Contributing to the improvement and development of training in vocational training centers and scientific centers.**
- 8- **Developing the areas surrounding the free zones and improving the yield of local energies.**

“Free Zones are responsible for exports worth at least 3,500 billion a year, equivalent to around 20 percent of global trade in goods”

11- Finding a productive industry that is a model for the local industry that is trying to join the foreign market.

12- Creating new knowledge that is fused with the skill of national institutions, i.e. management methods, financial techniques and marketing, all of this in order to improve the economic entity...

In general, governments aim to establish free zones for economic development, and achieving these goals depends on the ability of the regions to bring some institutions onboard, on the quality of the polarized institutions and the nature of the activities they practice, and this in turn depends on the guarantees, facilities and incentives offered by those zones.

FACTORS CONTROLLING THE SUCCESS OF FREE ZONES

The success of the free zones in attracting and encouraging foreign investments and achieving the desired goals and positive results on the economies of developing countries is associated to several basic factors, the most important of which are:

- 1- Carrying out preliminary studies before establishing free zones, including:
 - a. Detecting potential opportunities to establish free zones in several districts;
 - b. Inspecting economic resources.
 - c. Studying global markets to find out the most important investment opportunities that can be promoted.
- 2- Choosing the locations of the free zones and planning them well in terms of:
 - a. Communication services.
 - b. Roads and mode of transportation.
 - c. Securing infrastructure.
 - d. The environmental and topographical suitability of the site with the type of activities intended.
 - e. Determining the appropriate size of the free zone, taking into account future expansions.
- 3- Political and economic stability and appropriate investment climate:

The most prominent obstacles to attracting investments in any country are the existence of disputes, internal disturbances, labor strikes, continuous change of governments, wars, and permanent change of economic policies related to investment activity, as all of this leads to negative effects on the general economic activity and the failure to attract foreign investments and capital escape.

- 4- Availability of labor at low cost.
- 5- Linking the objectives of the licensed projects to the general objectives of the government.
- 6- The administrative efficiency of the management of free zones: creating the conditions for the establishment of projects, simplifying the procedures, providing the necessary services, and facilitating the trade of projects with various authorities.
- 7- Benefits and incentives granted:
 - a. Material incentives
 - b. Material incentives, including customs incentives
 - c. Tax exemption incentives
 - d. Other incentives, such as the none-restrictions on dealing in foreign exchange or money transfers and profits.

To conclude, despite the darkness seen in the current situation in Lebanon, a lot can be done to alleviate this dark cloud from above the country, with a little vision and a lot of willingness. It is true that this project is seen to be implemented in the Byblos and Beqaa regions due to the adequacy of these locations, and it can contribute to achieving the goals of social and economic development provided that these areas should be included in the priorities of the economic recovery program, and a lot of opportunities can be found on the other sides of the country; another opportunity with another vision.

Firas El Hussein, lawyer, holding a Public Private Partnership & infrastructure degree from Kennedy School of Government, Harvard; Mini MBA in Petroleum Industry Dynamics from Euromoney. With expertise in infrastructure and Oil & Gas contracts and other areas of practice.